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SUBJECT: TURKISH ECONOMY MARCH 24: ERDOGAN SPEECH DOESN'T
STEM MARKET DOWNTURN

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1. (SBU) Summary: On Sunday evening March 23, PM Erdogan addressed the nation committing the new GOT to continue the economic reform program and to take additional reform measures if needed. But markets weren't buying, and yields on T-bills rose 5.5 percentage points in morning trading March 24. Bankers told us they are concerned with a steady outflow of dollar deposits, not large amounts and not panic withdrawals, but still a cause of concern. At 1:30 pm local time, GOT spokesman Cicek made a press statement on further reform measures adopted by the Cabinet. End Summary.

Markets Weaken Sharply -----

2. (U) In morning trading March 24, the lira depreciated about one percent to TL 1,748,000 and the Istanbul Stock Exchange dropped 3 percent. Yields on the benchmark lira-denominated T-bill rose to 73.5 percent compounded. Trading volumes were low in all markets, as foreign investors had largely exited the markets last week.

PM Erdogan Commits to Continue Reforms -----

3. (U) In a televised address to the nation at 9:00 pm Sunday March 23, PM Erdogan committed the new GOT to continuing the reform program and to take additional measures, if needed. The speech was mostly about calming the public on the effects of the Iraq war in general (see reftel for full text.) In the economic portion, he said he expects to finish the IMF Fourth Review in the first half of April, mentioned the need to reduce public sector employment, and warned ministers against freelancing statements or actions. The economic portion of the speech follows:

-- "Our government has the political will to proceed with the existing program carefully and meticulously. We will not allow the economic program to collapse by giving as an excuse the difficult conditions. I believe we have to strengthen our fiscal and economic policies."

-- "The 2003 budget will provide a primary surplus of 6.5 percent of GNP. Measures to prevent waste in the social security and health care systems have been undertaken. In the past two months, the primary surplus targets have been met and tax revenue was TL 580 trillion more than expected. The arrangements to eliminate redundant employment (in the public sector) are being dealt with urgently and will be resolved by the year-end."

-- "We expect the Fourth Review to be concluded in the first half of April....I have given the necessary instructions to all the ministers and civil servants. No one should take into consideration any statements or behavior which are outside the program."

4. (SBU) IMF resrep in Ankara told Reuters March 24 am that "the IMF welcomes the commitments to economic policies made by Prime Minister Erdogan last night, and looks forward to working with the Government to finalize the letter of intent

for the Fourth Review." Resrep told us Erdogan had dropped specific policy measures contained in an earlier Treasury draft of the economic portion of the speech. Nevertheless, resrep saw Erdogan's speech as an important first commitment by the new GOT to the IMF program. He said he understood Treasury was seeking to get full GOT approval for further fiscal measures, possibly as early as the March 24 pm Council of Ministers meeting.

15. (SBU) Erdogan's speech is partly a reaction to a tough message from IMF headquarters delivered by resrep to Treasury U/S Oztrak on March 21. This message came after recent negative statements and actions by GOT ministers. On March 21, Energy Minister Guler announced he was seeking Cabinet approval to lower electricity prices by 1.5 percent, and would also reschedule outstanding electricity payment arrearages amounting to TL 2.4 quadrillion lira. (This would contravene an LOI commitment not to reschedule any public sector receivables.) Also on March 21, the Public Works Minister announced he was moving forward on amending the Public Procurement Law (contravenes a commitment in the draft LOI). World Bank economist Jim Parks told us March 24 that Treasury told the Bank it would seek to kill both of these initiatives before they got before the Cabinet.

16. (U) At 1:45 pm local time, GOT spokesman (and Justice Minister) Cicek told reporters after a Cabinet meeting that the draft 2003 budget would include an additional \$2.3 billion of spending cuts and would obtain approval for the privatization of TEKEK.

Markets Not Impressed;
Concern with Dollar Outflow

17. (SBU) Erdogan's speech did not lift the general pessimistic mood prevailing in the markets. Credit Suisse's Istanbul analyst Berna Bayazitoglu wrote on March 24 am, "henceforth, actions will be far more important than words." Zafer Kurtul, General manager of Turkey's largest private sector bank, Akbank, told us "Erdogan said nothing new."

17. (SBU) Kurtul said the major concern in the banks is with the outflow of foreign currency deposits. He said about 55 percent of deposits in Turkish banks are currently F/X-denominated. Akbank has about \$6.5 billion in F/X deposits and about 4 quadrillion (\$2.5 billion) in lira deposits. He estimated about \$20 million outflow of F/X deposits from Akbank in the past two days, and he surmised that in Turkey's less solid medium-size banks the outflow would be larger. F/X outflow takes the form of bank withdrawals in cash which stay in Turkey and transfers of deposits to foreign banks overseas. Kurtul added that this dollar outflow would not directly affect the GOT's ability to borrow from the banks in lira terms, since the banks' lira funding costs are not increasing at the moment. Turkish banks fund lira debt purchases currently from two sources, the overnight money markets and lira deposits, and interest rates in both markets are currently stable. But he noted that the GOT has a major debt redemption in June in F/X terms, which would be affected by the F/X outflow. For now, he predicted that Turkish banks will raise their F/X deposit rates to try to stem the F/X outflow.

18. (U) The worried tone of some press commentary may be supporting the beginnings of outflow of dollars from the banks. For instance, Star newspaper (tabloid-style, owned by Motorola deadbeat Cem Uzan) of March 23 carried an editorial entitled, "Stay in cash, Keep your money in a Safe Place," by Salih Neftci, a widely read columnist. The column warns readers that Turkey is headed towards bankruptcy and advises to pull money out of the banks. As of March 24 mid-day, there is no sign of panic in the public or any runs on banks.
PEARSON